United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 12928

Estate of Herbert B. Hatch, *Deceased*, Juanita O. Hatch, Executrix and American Trust Company, Executor; Juanita O. Hatch and Herbert B. Hatch, Jr., *Petitioners*,

vs.

Commissioner of Internal Revenue, *Respondent*.

On Petition to Review a Decision of the Tax Court of the United States.

REPLY BRIEF FOR PETITIONERS.

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SUMMARY.

A considerable portion of Respondent's brief reargues the already settled question of whether a partnership interest can be sold as a capital asset or whether a sale by partners is a sale of the individual partner's undivided interest in each partnership asset.

Respondent's argument has been uniformly rejected by the Courts (Pet. Br. 13, 14) and repudiated by the Commissioner himself (Pet. Br. 22). Likewise, Respondent's argument seizes upon trifles in an effort to distinguish this

case from the authority relied upon by Petitioner (Pet. Br. 13, 14) and fails to meet Petitioner's argument that the transaction in question was in "substance and effect" as well as in "form and appearance" a sale of the partnership interests.

THE TAX COURT'S FINDINGS OF FACT.

This case was tried in the Tax Court solely upon stipulated facts. The government's brief relies upon and attempts to perpetuate certain erroneous findings of the Tax Court (R. 69-74) and unjustified inferences which find no support in the Stipulation of Facts—the only evidence of record (R. 40-59).

The facts as stated by Respondent are essentially those of the Tax Court (Resp. Br. 2-6). In comparing such conclusions with the Stipulation of Facts, important errors involving unjustified inferences are evident. The Stipulation provides that:

> "13. Prior to February 21, 1944, the Hatch Chevrolet Co. operated its business under a franchise from the Chevrolet Division, General Motors Corporation" (R. 45)

Upon the basis of the wording of the Stipulation, the Tax Court found that:

> "The business was operated under a franchise from the Chevrolet Motor Division of General Motors Corporation. The record does not show whether that franchise was either valuable or transferable" (R. 69, Resp. Br. 3).

The Tax Court also found that:

> "The property transferred to Chase included all of the assets of the partnership except the General Motors franchise, two automobiles, cash in a substantial amount, and the partnership name. Chase assumed a part, but not all, of the liabilities of the partnership" (R. 70, Resp. Br. 5).

In addition to the portion of the Stipulation above cited, this finding was also based upon the "Agreement of Sale" (Exh. 2-B, R. 52) which was attached to the Stipulation and which provided that:

> "Second party shall, upon taking possession, have permission to operate the business under the name of Hatch Chevrolet Company for a limited period of time to enable him to make the necessary arrangements for the future title or trade name of said business."

and Paragraph (4) of the Stipulation which reads in part, (R. 42)

> "... It (the 'statement') does not include cash in the bank which was retained by the partnership in the amount of $35,249.90 and two automobiles having a book value of $1,542.66, and certain liabilities not assumed by the purchaser in the amount of $15,588.55".

The above quotations must be analyzed in the light of the terms of the "Agreement of Sale" that:

> "... first parties will sell to second party all of the *business* and assets of Hatch Chevrolet Company, a co-partnership, and thence forward (second party) shall operate said *business* to all intents and purposes as though this transaction had been completed and title thereto passed to the party of the second part." (R. 51, 52) (Emphasis supplied)

It is difficult to understand how the Tax Court, from this evidence could determine that:

> "The stipulated facts show that the partners made no effort to sell and Chase did not buy their individual interests in the partnership or any part of those interests, but on the contrary, the subject of the sale was part of the partnership assets subject to a part of the partnership liabilities." (R. 74)

Furthermore, it is equally difficult to understand how the Tax Court could further determine that:

> "The partnership was not terminated by the sale. It retained some of its assets and the amount realized

> from the sale. Later it distributed its assets to the individual partners in liquidation." (R. 74)

These determinations of the Tax Court completely distort the logical conclusions to be drawn from the evidence. Respondent's argument in his brief increases this distortion, hence, each error merits additional analysis.

SALE OF PARTNERSHIP INTERESTS.

Proof of the sale of partnership interests as distinguished from the sale of assets has been fully discussed (Pet. Br. p. 8-14).

The fact that the "Agreement of Sale" recited an inventory to be taken to determine the price of the sale (R. 52) appears to have confused the Tax Court and the Respondent into seeing nothing involved but a sale of assets.

Such a standard business procedure of using the inventory value of underlying assets to determine the value of each of the partnership interests did not prevent the sale from being that of partnership interests in the Thornley case. *Thornley* v. *Commissioner,* 147 F. 2d 416 (CA-3, 1945)

However, Respondent (arguing in support of the Tax Court's findings) attempts to compress this entire case into the one sentence: "the necessary conclusion is simply that the partnership (or taxpayers as partners) sold and Chase purchased personal property, such as equipment, parts, cars, etc., with which to conduct a garage business" (Resp. Br. 29). To buttress this "necessary conclusion" the government states that "the garage in which the business was conducted" was not included (Resp. Br. 13).

The references to a "garage business" are distortions of the record. The only references to the primary nature and scope of the business conducted by the partnership is to be found in the partnership agreement: "The parties hereto agree to associate themselves as co-partners in the business of selling, distributing, repairing, and servicing

motor vehicles and motor vehicle parts both at wholesale and retail" (Exh. 1-A, R. 45, 46) and in the Stipulation that "prior to February 21, 1944, the Hatch Chevrolet Co. operated its business under a franchise from the Chevrolet Motor Division, General Motors Corporation" (R. 45).

Based upon these simple statements of fact, the government urges the existence of a garage, concerning which the record is entirely silent. It argues that this case should be affirmed because that "garage" which Respondent has fabricated, was not included in the bill of sale (Resp. Br. 13).

Repairs of vehicles and the sale of parts were naturally incidental to and arose from the main purpose of the partnership enterprise and so necessarily passed with a sale of the business.

Yet the government further concludes (Resp. Br. 29) that only a "garage business" was sold because the sale did not cover the Chevrolet franchise and good will. (Resp. Br. 29). The reference to the franchise in the record is merely the narration of a past fact and has no evidentiary value in the determination of this case. (Stip. par. 13, R. 45).

The record does not disclose the terms and conditions of the franchise. The Tax Court should be precluded from speculating, as it did, as to the contents of the franchise or its treatment as an asset. By predicating its opinion upon hypothesis rather than fact, the result deprives the government's argument of all force and effect.

It is common knowledge in the automobile industry that a General Motors dealership franchise is a standard form contract, personal in nature and specifically retains "good will", if any, to the manufacturer upon termination of the franchise. These facts have been recognized by the Tax Court in *Floyd D. Akers* v. *Commissioner of Internal Revenue,* 6 T. C. 693, 694, wherein the Court stated:

> "The franchises under which the corporation operated were not assignable and were 'personal contracts' between the General Motors Corporation and petitioner.

> ". . . The franchises were the standard forms used by the General Motors Corporation for the exclusive sale of its products in specified territory and were similar to the forms used by the automotive industry as a whole."

Continuing, the Court stated (P. 700)

> ". . . These names [of the cars sold] and the good will attached thereto were specifically reserved to the General Motors Corporation in the franchise agreements, in which no provision was made for payments for good will or going concern value in the event of their termination. . . .
>
> ". . . The good will, if any, continued to be embodied in the franchises and they, under the circumstances, were not property subject to transfer or other disposition by the corporation. Noyes-Buick Co. v. Nichols, 14 F. 2nd 548."

The retention by the Hatches of immaterial assets has been fully discussed by petitioner. (Pet. Br. 14-18).

An important fact, overlooked by the Tax Court, is that the purchaser, Chase, in buying the interests of the partners, did, as a result, thereby receive a going business concern, as in the *Thornley* case, *supra,* which he, Chase, operated from 8:00 o'clock A. M. on Monday, February 21, 1944 (R. 52) and for which he agreed to protect the former partners from liability for the continued use of their name as the name of the business. (R. 54).

Certainly the elimination of immaterial assets and liabilities from the calculation of the value of the partnership interests and the retention of such by the Hatches cannot prevent the sale from being that of partnership interests.

Respondent argues that the case of *Randolph Products Co.* v. *Manning,* 176 F. 2nd 190, limits the application of the *Thornley* case (Resp. Br. 23-24). The *Randolph* case involved rental income received by corporation from a partnership. One of the partners owned 94% of the stock of the Corporation. The issue presented was whether the cor-

poration was a personal holding company and how its income should be taxed. The case can, therefore, be distinguished on the facts, the issue presented and the sections of the Code involved.

Again, Respondent is merely re-opening and re-arguing the now settled law, confirmed by the overwhelming weight of authority (and the Commissioner's General Counsel himself*) which treats the sale of a partnership interest as the sale of a capital asset (Pet. Br. 22, 23).

For this same reason, Respondent's lengthy comments concerning the case of *Commissioner* v. *Whitney*, 169 F. 2nd 562—certiorari denied, 335 U. S. 892, can be disregarded (Resp. Br. 21).

TERMINATION OF THE PARTNERSHIP.

The erroneous conclusion of the Tax Court (R. 74) and argument of the Respondent (Resp. Br. 15) that the partnership composed of the Hatches continued after the sale to Chase involves not only the question of the retention of minor assets and liabilities by the former partners, but also a disregard of the controlling law.

The Tax Court, as well as respondent's brief, has confused the termination of the partnership with the distribution between the former partners of the proceeds of the sale.

The Tax Court stresses the fact that the partners retained "the amount realized from the sale", and made distribution "later" (R. 74). All they really did was to merely collect the money for their interests. It was not, and could not have been, the conduct of "a business for profit" which is the characteristic of a partnership under Section 2400(1) of the California Civil Code (Pet. Br. 19). Chase took over the Hatch Chevrolet Company bank account (Exh. 4-D, R. 60) and the Hatches deposited the check given in payment for their interests in a different bank to

* (GCM26379, Pet. Br. 22).

conveniently clear it. They couldn't very well cut it into pieces. Withdrawing the money as they did was the natural and orderly way to do it.

All they did was to proceed under the applicable California law which the Tax Court failed to recognize. The sale to Chase terminated the partnership and nothing remained thereafter except to distribute the proceeds among the former partners.

CONCLUSION.

It is respectfully submitted that the sale by the Hatches was the sale of their partnership interests and should be treated as the sale of capital assets. Since the decision of the Tax Court is predicated upon erroneous conclusions drawn from the evidence as well as inferences of fact not justified by the record, and is contrary to law, it should be reversed.

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